

# Neptune Group Limited (70 HK)

9 Nov 2012



## A High-end VIP Niche Play

### 3Q performance beats overall VIP market

Our recent channel checks indicate that 3Q rolling chip turnover (“RCT”) performance of Neptune Group Limited (“Neptune”) has increased by approximately +2.5% QoQ, while the overall VIP market’s total RCT dropped by -2.6% QoQ.

### High-end VIP rooms are defensive

Management of Neptune attribute their outperformance to the fact that high-end VIP rooms are more defensive than the average VIP rooms as their ultra high net worth patrons are less affected by economic downturn. Hence we saw average VIP tables generate RCT of approximately HK\$250-270 million per table per month compared with Neptune’s average of approximately HK\$290-310 million during FY2012.

### Gaining market shares

Compared with its peers operating in the same casinos, Neptune’s market share in terms of RCT generated has increased from 14% in June to 16% in September. Whilst smaller junkets are struggling to achieve minimum RCT per table, we believe Neptune can further increase its market shares given its higher clientele quality and stronger financial standing.

### Reiterate Buy

Based on higher than expected annual results, gains in market shares, contribution from increased stakes in existing profit sharing agreements and potential expansions, we have revised up our forecast FY2013 EPS. The current share price of HK\$0.158 represents a FY2013 PER of just 2.0x. Moreover, as Neptune is the only listed junket pure play in Hong Kong, it provides investors with a unique and focused platform to invest in Macau’s VIP gaming market. We therefore reiterate our “Buy” rating on the counter.

China/Hong Kong

**Rating** Buy

Price (9 Nov 12) HK\$ 0.158

Market Cap HK\$608M

US\$77.9M

Sector Gaming

### Research Analyst

Elisa Chan

elisa.chan@ffinancial.com.hk

+852 3103 0548

Please refer to the important disclosure and analyst certification information at the end of this report

## Forecast Summary

(HKD '000, 30 <sup>th</sup> Jun)	2011a*	2012a*	2013e
Revenue	414,787	433,377	1,205,159
Net profit	356,584	439,965	1,208,652
Attributable profit	193,265	281,399	470,149
Fully diluted EPS (HK cents)	5.03	7.31	10.36

Note: Company information assuming successful expansions into new casinos.

Source: FT Securities estimates

Assuming potential expansions are funded by issuance of new shares.

\* Cruise ship leasing business excluded.

**Key takeaways from channel checks and meeting with management:**

## 1. Is premium mass a challenge to VIP business?

No, it is not a challenge at all as they represent two very different markets.

In terms of RCT, a premium mass table generates typically 90% less than a VIP table. It is because VIPs usually bet several millions of dollars on credit a night whereas premium mass players buy several thousands of non-negotiable chips by cash per visit so they can receive free hotel rooms, jetfoil tickets and meal vouchers. In comparison, the VIPs don't only receive these perks, they will be given fine dining at five star hotels, comprehensive travel agency services, limousine and even private jet transportation. As the two classes of players are markedly different in terms of their respective wealthiness, the Neptune management do not perceive premium mass market as a threat to the VIP business. Instead, once their personal wealth increases, premium mass players are likely to upgrade themselves to play in the real VIP rooms and receive the real VIP treatments. Therefore, they are Neptune's potential customers in the future.

## 2. What is the recent performance of Neptune's VIP rooms?

Neptune's VIP rooms have generated RCT growth of approximately 2.5% between 2Q12 and 3Q12, having outperformed the market by 5-6% QoQ.

Market has been negative on the outlook of VIP market due to the slower pace of growth at major casinos in 3Q12. The VIP RCT for the overall market has declined by 2.6% in 3Q12 when compared to 2Q12. VIP RCT generated within the Neptune casino network, comprising Sands Macao, The Venetian and Galaxy StarWorld, also reported a decline of 3.9% over the same period. However, Neptune's junket portfolio has achieved a RCT growth of 2.5% in the same period amid this challenging environment.

## 3. What is recent change of Neptune's market share?

Neptune's market share in terms of RCT generated within its casino network has increased from 14% in June to 16% in September 2012.

Amid the tight credit environment and slowdown of the overall VIP market, smaller junket operators have been struggling to achieve minimum required RCT per table of HK\$200 - 250 million per month in order to survive. While the VIP market's averaged RCT per table per month is approximately HK\$270 million, Neptune delivers a monthly average of HK\$300 million per table. Management expects that Neptune will continue to increase market shares in 2013 as its high-end VIP customers enable it to outperform in the VIP market while the less capitalized small junket operators find it hard to provide credits to VIP players.

4. Why the Company has little exposure in Cotai area? Why all potential acquisitions are based in Macau Peninsula?

The Company always invests in proven and stable profit streams from top performing VIP rooms in top-tier casinos which are still concentrated in Macau Peninsula. Apart from The Venetian, other casinos in Cotai Strip have yet to build up their stable and proven track records for Neptune to consider investing.

As Neptune intends to raise funds by issuing new shares for its potential investments in new profit streams, only mature and stable VIP rooms are able to deliver immediate returns, hence minimizing the dilution effect on EPS. As most of the casinos in Cotai are new with the VIP business being developed, the conservative management don't have that many choices. As the private Neptune Macau Group is operating and building up VIP businesses at the City of Dreams and Altira in Cotai, these will become Neptune's investment opportunities in the future when they become up and running.

6. What is the basis of valuation of the acquisitions?

Valuation metrics such as payback period, IRR and cost of capital have been used by the management on assessing the investment opportunities. As for PE multiples (same as price-to-revenue here), the Company has always acquired asset at lower PE than its own in the past.

7. Which city/province are most of the VIP players from? How many of them come from Guangdong?

40-50% of the VIPs are from Guangdong province while other provinces such as Fujian, Zhejiang and Shandong contribute 10% each. The management is seeing growth from the western provinces and cities such as Sichuan and Guizhou. Shanghai, Beijing and Shanxi are stable sources of ultra high net worth players.

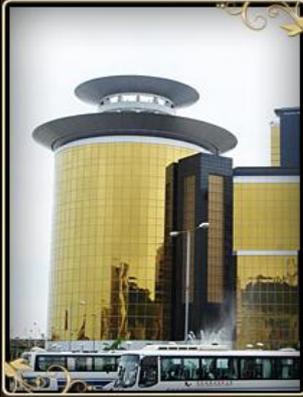
8. Why are junket operators willing to sell the VIP business at low price-to-revenue?

Junket operators need cash for expanding their networks of VIP rooms. As there is an increasing number of casinos being opened and a lot of smaller junket operators are being squeezed out, the bigger junket operators are desperate for funds to gain market shares.

**Increasing stakes in profit sharing agreements**

In January 2012, Neptune acquired an additional 10% of a company which shares 0.35% of RCT generated by 12 VIP tables at Sands Macao for a consideration of HK\$108,000,000. In June 2012, Neptune acquired an additional 10% in another company which shares 0.4% of RCT generated by 17 VIP tables at Galaxy StarWorld for a consideration of HK\$96,300,000.

**Figure 1: Current Profit Network**

Casino Operator	Sands China (1928.HK)		Galaxy Ent. (27.HK)				
Casino	Sands Macao	The Venetian		Galaxy StarWorld			
							
<b>Number of Tables</b>	12	12	4	6	17		
<b>% of RCT shared</b>	0.35%	0.4%		0.4%			
<b>Stake in Profit Sharing</b>	20%	10%	85%		20%	10%	10%

Orange boxes: New stake acquired in FY2012

Source: Neptune and FT Securities

**Potential expansion into 3 top casinos**

Neptune announced in August 2012 that it had entered into three memorandums of understanding (“MOUs”) in relation to possible investments in the profit streams of particular VIP rooms located at Grand Lisboa, MGM Sky and Wynn. Upon completion of these investments, Neptune’s investment portfolio will be expanded to cover five out of the six licensed casino networks in Macau.

**Figure 2: Potentially Enlarged Casino Network**

Blue boxes: Casinos to which Neptune's investment portfolio will be expanded according to MOUs

Source: Neptune and FT Securities

### Reiterate Buy

Based on higher than expected annual results, gains in market shares, contribution from increased stakes in existing profit sharing agreements and potential expansions, we have revised up our forecast FY2013 EPS. The current share price of HK\$0.158 represents a FY2013 PER of just 2.0x. Moreover, as Neptune is the only listed junket pure play in Hong Kong, it provides investors with a unique and focused platform to invest in Macau's VIP gaming market. We therefore reiterate our "Buy" rating on the counter.

**Figure 3: Gaming Players Valuation Metrics**

Company	Stock Code	Mkt Cap (HK\$m)	PER (x)	PER (x)	PER (x)	EV/ EBITDA (x)	EV/ EBITDA (x)	EV/ EBITDA (x)	EBITDA Margin (%)	EBITDA Margin (%)	Net Profit Margin (%)	Net Profit Margin (%)
			FY11	FY12E	FY13E	FY11	FY12E	FY13E	FY12E	FY13E	FY12E	FY13E
<b>HK-listed Players</b>												
SANDS CHINA LTD	1928 HK	242,377	27.9	25.6	17.5	21.7	17.7	13.5	28.8	30.1	18.6	21.9
WYNN MACAU LTD	1128 HK	113,607	19.9	17.8	16.1	15.7	13.8	12.7	26.9	27.2	22.4	23.0
GALAXY ENTERTAINMENT GROUP L	27 HK	114,179	37.6	15.7	13.8	25.0	12.2	11.0	16.7	17.1	12.7	13.4
SJM HOLDINGS LTD	880 HK	97,185	17.8	14.5	12.9	12.5	10.6	9.4	9.6	10.0	8.3	8.6
MELCO CROWN ENTERTAINMENT LT	6883 HK	61,846	n/a	19.8	16.1	11.1	10.0	9.0	22.5	23.1	10.3	11.5
MGM CHINA HOLDINGS LTD	2282 HK	52,516	15.9	11.5	11.2	10.7	9.7	9.1	24.6	24.6	20.9	20.1
<b>Simple Avg</b>			<b>23.8</b>	<b>17.5</b>	<b>14.6</b>	<b>16.1</b>	<b>12.3</b>	<b>10.8</b>	<b>21.5</b>	<b>22.0</b>	<b>15.5</b>	<b>16.4</b>
<b>Mkt Cap Weighted Avg</b>			<b>23.3</b>	<b>19.4</b>	<b>15.4</b>	<b>18.1</b>	<b>13.8</b>	<b>11.6</b>	<b>22.8</b>	<b>23.5</b>	<b>16.2</b>	<b>17.7</b>
<b>US-listed Players</b>												
LAS VEGAS SANDS CORP	LVS US	272,552	25.5	19.9	16.6	13.3	11.9	10.2	32.3	33.0	15.7	17.5
WYNN RESORTS LTD	WYNN US	85,122	22.5	20.5	18.3	9.6	9.5	8.8	30.3	31.1	10.9	11.6
MELCO CROWN ENTERTAINME-ADR	MPEL US	60,788	26.5	20.6	18.6	11.0	9.9	9.5	22.4	22.2	9.8	10.2
MGM RESORTS INTERNATIONAL	MGM US	37,064	1.6	n/a	n/a	15.4	10.4	9.7	20.8	21.7	n/a	n/a
<b>Simple Avg</b>			<b>19.0</b>	<b>20.3</b>	<b>17.8</b>	<b>12.3</b>	<b>10.4</b>	<b>9.6</b>	<b>26.5</b>	<b>27.0</b>	<b>12.1</b>	<b>13.1</b>
<b>Mkt Cap Weighted Avg</b>			<b>23.2</b>	<b>20.1</b>	<b>17.2</b>	<b>12.5</b>	<b>11.0</b>	<b>9.8</b>	<b>29.7</b>	<b>30.3</b>	<b>13.8</b>	<b>15.2</b>

Source: Bloomberg, 9<sup>th</sup> Nov, 2012

**Key Drivers**

- VIP rooms operated by a close long-term business partner, Neptune Macau Group are potential investment opportunities for the Company.
- High-end VIP clientele securing Neptune's outperformance in the overall VIP gaming market.
- Team of junket managers with more than 25 years of experience in international gaming.
- Attractive valuation when compared with Hong Kong listed casino plays with average PER of 18-20x.
- FY2013 earnings expected to grow robustly due to:
  1. full year contribution from increased stakes in profit shares at Sands Macao and Galaxy StarWorld, adding approximately 12-15% to earnings.
  2. the taking up of market shares from smaller junket operators.
  3. continued investments in more profit streams of high quality VIP rooms.

**Risks**

- Slow recovery of global economic slowdown.
- Increased competition.

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